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Congress of the United States
House of Representatives
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The Honorable Janet Napolitano
Secretary
Department of Homeland Security
Washington, DC 20528

Dear Secretary Napolitano:

I am writing to bring to your attention recent statements by insurance company attorneys that show beyond any doubt that companies shifted Hurricane Katrina claims to the National Flood Insurance Program that should have been covered by their own homeowners policies.

On June 9, 2009, the Mississippi Supreme Court heard oral arguments on the interpretation of "anti-concurrent causation" (ACC) clauses in homeowners insurance policies. The attorney for Nationwide, Christopher Landau, told the Supreme Court that Nationwide applies the ACC clause to exclude coverage of all damage caused by hurricane winds if subsequent flooding was sufficient to cause the damage.

In response to questioning, Landau answered that even if a house were 95 percent destroyed by winds before any flooding, Nationwide would owe nothing to the policyholder if the flooding was severe enough to have destroyed the house.

JUSTICE PIERCE: So you're sequencing, if 95 percent of the home was destroyed, and then we have the event of the storm surge, then you would not pay a dime?

MR. LANDAU: Your Honor, if we prove that the storm surge was sufficient to cause - we have that burden, again, and that is absolutely crystal clear.

If we can prove that the storm surge was sufficient to cause all of this, it is no answer then to say, 'Yeah, but I'm going to show it -- I'm going to have somebody come in and say, "Look, guess what, the window was broken before the storm surge came and then wiped away the whole house.'

But you don't get into those kinds of issues precisely because of the sequencing of the damage.

JUSTICE PIERCE: So you wouldn't pay a dime?

MR. LANDAU: If - again, we wouldn't pay a dime for things where we can carry our burden, which is right there in the policy, of showing that the loss was caused concurrently -

JUSTICE PIERCE: I'm giving you -- the example is 95 percent of the home is destroyed, the flood comes in and gets the other five percent, and you know that.

Does your interpretation of the word "sequence" mean you pay zero?

MR. LANDAU: Yes, your Honor.

USAA's attorney Greg Copeland offered a slightly more reasonable interpretation of ACC, but the effect is still to shift some of USAA's costs to NFIP. USAA acknowledges that it must pay for damage caused by wind acting independently from flooding, but insists that it owes nothing on losses caused by wind if flooding is a contributing cause. In fact, Copeland asked the Court to mandate instructions to juries telling them that if they conclude that a loss is caused by the combination of wind and flooding, it is covered by NFIP and not by the homeowners policy.

Copeland even claimed that it was the intent of Congress when enacting the National Flood Insurance Program that the federal government should pay for all damage caused the combination of wind and flooding.

JUSTICE CHANDLER: And back to this word of "synergistic" or concurrent combined forces of wind and water, if the jury is told that if they believe it was a combined concurrent force of wind and water that caused the damage, you're going to say that the Plaintiff is not entitled to damages?

MR. COPELAND: Yes, sir.

JUSTICE CHANDLER: But now as I understood the Plaintiff, the Plaintiff is going to argue that, if there are combined forces, then they are entitled to payment because the per square inch of force from water alone is insufficient to cause the damage.

MR. COPELAND: Yes, sir.

JUSTICE CHANDLER: That's really the disagreement between the two sides that matters; is that correct?

MR. COPELAND: Yes, sir. And that's what this second sentence in this policy addresses.

JUSTICE CHANDLER: I'm looking at it.

MR. COPELAND: And it was - it had to go somewhere. It did not go in the homeowner's policy. It went in the National Flood Insurance. That's what Congress did.

The National Flood Insurance Act does not obligate NFIP to pay for any wind damage that occurs in combination with flooding. In fact, the regulations specify that Write Your Own insurance companies have a contractual obligation to represent NFIP and federal taxpayers when handling flood claims. They have a fiduciary responsibility that prohibits them from placing their own corporate interests ahead of NFIP's interests.

Several companies blatantly violated that obligation by insisting that the Anti-Concurrent Causation clauses in their homeowners policies excluded coverage of wind

damage if flooding contributed to the loss. Under the current system, NFIP allows insurance companies to handle flood claims backed by federal taxpayers while they also handle their own homeowners claims for wind damage. GAO described this arrangement as an "inherent conflict of interest."

Properties on the Mississippi Gulf Coast suffered four hours of hurricane force winds, with gusts as high as 140 mph, before the storm surge. GAO concluded that NFIP performed almost such poor oversight of flood claims that it did not collect enough information to be able to verify that NFIP paid only for damage caused by flooding.

After Hurricane Katrina, State Farm initiated an industry lobbying campaign to persuade NFIP Administrator David Maurstad to waive the requirement for proper investigation of flood claims. State Farm drafted NFIP's Expedited Procedures for Hurricane Katrina, and was so confident in their approval that State Farm claims managers implemented the procedures almost two weeks before they were adopted.

On September 9, 2005, the State Farm Flood Coordinator in Mississippi, Alexis "Lecky" King, emailed adjusters who were handling both claims, that "the flood claim should be resolved, paid and closed. However, the wind claim will remain open pending the investigation and resulting findings." On September 13, 2005, State Farm sent its adjusters a document entitled, "Wind/Water Claim Handling Protocol" which instructed them that "where wind acts concurrently with flooding to cause damage to the insured property, coverage for the loss exists only under flood coverage."

State Farm, Allstate, Nationwide, and other companies sent their adjusters out to pay full policy limits on flood policies before investigating how much damage had been caused by flooding and how much had been caused by wind and wind-driven debris. The insurers then delayed and denied claims for wind damage under their own policies, forcing thousands of policyholders to sue.

GAO also found that insurance companies received windfalls from NFIP by collecting much more in adjustment reimbursements and administrative subsidies than the companies spent handling flood claims. Additionally, federal taxpayers paid billions of dollars for FEMA trailers, housing vouchers, homeowner assistance grants, subsidized loans, and casualty loss tax deductions to assist homeowners during the year or two or three while they waited for an insurance settlement or court date.

I urge the Obama Administration to support H.R. 1264, the Multiple Peril Insurance Act, to protect homeowners and taxpayers by creating an option in the National Flood Insurance Program to offer coverage of both wind and flood risk in one policy.

By covering wind and flood risk in one policy, the multiple peril option will allow coastal homeowners to buy insurance and know that hurricane damage would be covered. They would not need lawyers, engineers, and public adjusters to distinguish between wind and flood damage.

The bill requires premiums for the new coverage to be risk-based and actuarially sound, so that the program would be required to pay for itself. The Congressional Budget Office estimated that the multiple peril program would be budget neutral.

Every taxpayer in America will benefit from the Multiple Peril Insurance Act because much more hurricane damage would be covered by insurance premiums rather than by costly and inefficient disaster assistance programs. The new program also will reduce future hurricane damages by requiring local governments to adopt and enforce the windstorm building codes recommended by the International Code Council.

The current insurance system is not a competitive market, so the prices charged by insurers and reinsurers are not determined by market efficiency. The Wharton Risk Management Center at the University of Pennsylvania found that insurance premiums in some coastal areas are 5 to 10 times higher than the estimated losses that the insurance companies expect to pay.

There is high demand for homeowners insurance because most homeowners are required by their mortgages to purchase coverage. Even though insurance premiums have increased substantially in every coastal area since Hurricane Katrina, companies continue to reduce the availability of private insurance coverage. When supply does not respond to increases in demand and price, no one can credibly claim that the private market has the capacity or the desire to cover the hurricane insurance market.

In Gulf and Atlantic Coast communities from Texas to Maine, the private insurance market has collapsed. Insurers have dumped hundreds of billions of dollars of coastal properties into state wind pools and other insurers of last resort. Most of the state-sponsored plans are not able to spread risk efficiently and not able to build up sufficient reserves to cover a major hurricane.

The federal multiple peril program will spread coastal wind risk in a much more efficient manner than the state pools. Single state pools concentrate risk so that a large portion of the pool could be affected by a single event. In order to account for the capital to pay for a major hurricane, the pools are forced to charge excessively higher premiums to buy more reinsurance. The federal multiple peril insurance plan would cover a broad geographical area so that even a large hurricane would affect only a small percentage of the policyholders. The federal plan would establish a stable risk pool that would not have wild swings in premiums after each disaster.

The federal government can easily establish risk-based premiums and create an actuarially-sound program if the Administration commits to the effort and staffs the program with appropriately skilled professionals. There are several substantial differences between the proposal for actuarially-sound multiple peril insurance coverage and the existing flood insurance program.

First, the flood insurance program was not designed to pay 100% of its costs. The flood program grandfathered properties that were built before the flood maps were

implemented. Those properties receive subsidized premiums for the first \$35,000 of flood insurance. The new windstorm coverage in the Multiple Peril Insurance Act does not include any subsidies and requires that the premiums pay the full costs of the program.


Second, the flood insurance program is not responsible for levees, dams, and other structures, but it is often left with most of the bill when they fail. Much of the NFIP debt for Hurricane Katrina resulted from flooding that would not have happened if the levees and floodwalls had performed to expectations. Much of the recent flooding in the Midwest also was the result of levee failures. Flood risk also can be dramatically altered by developments elsewhere in the flood plain. Wind insurance premiums are much simpler than flood premiums because they do not require assumptions about the performance of levees, dams, and other structures.

Third, every Gulf and Atlantic state already has a state-sponsored wind pool or other insurance pool of last resort that collects detailed wind and loss data and contracts for hurricane risk models. The insurance industry also has compiled volumes of data on wind risk, which they use to determine which properties to cherry-pick while leaving the rest to the state-sponsored insurance pools. FEMA could easily acquire the same data and models that states and insurance companies use to determine hurricane wind risks.

The first goal of federal disaster policy should be to improve our preparedness for hurricanes and other disasters. One of the best ways to meet that goal is to ensure that more coastal homeowners have insurance that will cover hurricane damage promptly and efficiently, so they will not have to depend on federal disaster assistance. Another important goal should be to reduce future hurricane damage by encouraging stronger building codes and mitigation standards. The Multiple Peril Insurance Act would accomplish both of those goals in an efficient and fiscally responsible manner. I urge you and others in the Administration to actively support this legislation.

Thank you for your interest and attention to this important issue. I look forward to continued discussions about the need for disaster insurance reform.

Sincerely,



GENE TAYLOR
Member of Congress

GT:jbm

CC: Craig Fugate, FEMA Administrator
Ed Connor, NFIP Acting Administrator
House Financial Services Committee Members
Senate Banking, Housing, and Urban Affairs Committee Members